

No. 22802

IN THE

United States Court of Appeals  
FOR THE NINTH CIRCUIT

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THE SIXTY TRUST,

*Appellant,*

*vs.*

W.M. B. ENRIGHT, TRUSTEE, ETC.,

*Appellee.*

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OPENING BRIEF FOR APPELLANT.

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DEAN C. DUNLAVEY,  
CHARLES R. COLLINS,  
MARSHA K. McLEAN,  
GIBSON, DUNN & CRUTCHER,

634 South Spring Street,  
Los Angeles, Calif. 90014,

*Attorneys for Appellant.*

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### List of Abbreviations.

P. Petition

A. Answer to Petition for Reorganization

R. Transcript of Record

AR. Additional Transcript of Record

V. I Volume I of Transcript of Proceedings held on June 28, 1967

V. II Volume II of Transcript of Proceedings held on June 30, 1967

V. III Volume III of Transcript of Proceedings held on June 30, 1967

Tr. Transcript of Proceedings held on September 21, 1967

Ex. Exhibits to hearing held on June 28, 1967 and June 30, 1967

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### Statement of Jurisdiction.

The jurisdiction of the District Court was predicated upon Title 11 U.S.C. §§ 46, 502, 511 and 528, the action being one for corporate reorganization pursuant to the provisions of Chapter X of the Bankruptcy Act (Title 11 U.S.C. §§ 501-676).

University City, a California corporation [P. 1; R. 2], filed a Petition [R. 2] on April 25, 1967, seeking corporate reorganization, alleging that for six months prior to the filing of the Petition, it had maintained its principal place of business within the territorial jurisdiction of the Southern District Court [P. 1; R. 2]; that its business was the operation and development of real estate [P. 1; R. 2]; that its principal assets consisted of land [P. 2; R. 3]; that its principal liabilities consisted of various promissory notes secured by deeds of trust on said real property [P. 2; R. 3];

that it was unable to meet its debts as they mature [P. 3; R. 4]; that the value of its assets exceeded its total liabilities [P. 2; R. 3]; and that relief could not be obtained under Chapter XI of the Bankruptcy Act because no reorganization could be achieved without a reduction, extension or other satisfactory adjustment of at least some of its secured indebtedness [P. 4; R. 3].

After the District Court issued its initial Order Approving Petition, and Appointing Trustee, Order of Reference and Restraining Order [R. 23-28] and an Amendment thereto [R. 29], The Sixty Trust, a secured creditor of University City [A. 1-2; R. 37-38], filed its Answer to Petition for Reorganization [R. 37] pursuant to Section 137 of the Bankruptcy Act (Title 11 U.S.C. § 537), seeking a dismissal of the Petition as not having been filed in good faith (Title 11 U.S.C. § 546) on the ground, among others, that real property owned individually by certain shareholders, officers and directors of University City and encumbered by deeds of trust in favor of The Sixty Trust had been transferred to University City immediately prior to the filing of the Petition for the sole purpose of bringing said property within the injunctive power of the District Court so as to hinder, delay and prevent The Sixty Trust from proceeding with a foreclosure sale set for April 25, 1967, the date upon which University City filed its Petition [A. 4-5; R. 40-41].

After a two-day hearing on the issues raised by said Answer before the Referee in Bankruptcy pursuant to Section 144 of the Bankruptcy Act (Title 11 U.S.C. § 544) and the lodging of the Proposed Report, the Proposed Findings of Fact and Proposed Conclusions of Law by the Referee [R. 57-61] and the filing of

Objections thereto by The Sixty Trust [R. 62-75], the Referee, on August 16, 1967, filed the Report of Referee and Special Master [R. 76-77], Findings of Fact and Conclusions of Law of Referee and Special Master [R. 78-81] concluding, among other things, that the last-minute transfer of the real property to University City by its shareholders, officers and directors had not been fraudulent as to any creditor [R. 77], that the Petition had been filed in good faith and should be approved [R. 80], and that the request for a dismissal by The Sixty Trust should be denied [R. 80-81]. Thereafter, The Sixty Trust filed its Objections to Report of Special Master, Findings of Fact and Conclusions of Law Upon Contested Petition Under Chapter X [R. 84-96], and oral argument on the said Report, Findings and Conclusions and Objections thereto subsequently was presented to the District Court. Following the filing by The Sixty Trust of Supplementary Objections to Report of Special Master, Findings of Fact and Conclusions of Law Upon Contested Petition Under Chapter X on September 27, 1967 [R. 97-100], the District Court, on October 3, 1967, issued its Order Confirming Referee and Special Master's Report, Findings and Conclusions of Law and Approving Petition Pursuant to Section 144 [R. 102]. Thereafter, following execution by the parties of a Stipulation Re Order to the effect that the Order Confirming Referee and Special Master's Report, Findings, and Conclusions of Law and Approving Petition Pursuant to Section 144 involved more than \$500.00 and the approval of same by the District Court on October 27, 1967 [R. 105-106], The Sixty Trust, on October 26, 1967, duly filed a Notice of Appeal to the Court of Appeal Under Fed. Rules of Civ. Proc. Rule 73(d) from said Order [R. 107-108].

The jurisdiction of this Court on appeal to review the Order of the District Court is premised upon Title 11 U.S.C. §§ 47, 48 and 521.

### Statement of the Case.

This is an appeal by the Trustees of The Sixty Trust (hereinafter "The Sixty Trust"), a secured creditor of University City [R. 35-36, 37-40] from the Order of the District Court [R. 102] approving the Petition for corporate reorganization under Chapter X of the Bankruptcy Act (Title 11 U.S.C. §§ 501-676) filed by University City, a California corporation, the debtor herein [P. 1; R. 2].

The filing of the said Petition represented the latest step (to that time) in a long history of actions taken by University City to stave off its creditors, secured and unsecured, in an attempt to avoid the inevitable consequences of its financial impotency. Its precarious financial condition, as demonstrated by the financial statement attached as Exhibit "A" to the Petition [R. 7-21] is not of recent origin. In fact, the pattern of University City since its incorporation in 1959 has been one of a continual, pressing, seemingly insatiable, need for operating funds leading to frequent financings. University City, on three separate occasions during the period 1962 through 1964, obtained three loans from The Sixty Trust alone in the total aggregate amount of \$10,750,000.00 [V. I, 44:26-45:5; V. I, 52:6-12 and V. I, 59:11-18] secured by deeds of trust upon substantially all of the real property owned by University City. At the time of the filing of the Petition, University City remained indebted to The Sixty Trust in an amount in excess of \$10,390,000.00 [A. 3; R. 39]

and ninety-nine percent of University City's principal, if not sole, asset—land held for development and sale—was encumbered by deeds of trust in favor of The Sixty Trust [A. 3; R. 39].

University City has been in continual default to The Sixty Trust under its promissory notes and the deeds of trust securing the same since June 18, 1965; Notices of Default were filed by The Sixty Trust in January, 1966 [Exs. L and M]. In addition, University City was in default under promissory notes and deeds of trust originally executed in favor of Pacific Finance Corporation and assigned by the latter for valuable consideration to The Sixty Trust [A. 2; R. 38]. A Trustee's foreclosure sale under one of said deeds of trust was scheduled for April 25, 1967 [A. 2; R. 38], the date of the filing of the Petition, but was stayed and restrained by Order of the District Court [R. 27-28].

In addition, deeds of trust were held by The Sixty Trust encumbering approximately 900 acres of real property (hereinafter the Sorrento Property) owned by Carlos Tavares and Irvin J. Kahn [Ex. J], officers, shareholders and directors of University City [V. I, 19:16; V. I, 43:25-44:7]. The notes they secured were in default and Notices of Default and Election to Sell had been duly filed. Five days prior to the filing of the Petition for Reorganization by University City on April 25, 1967, Carlos Tavares and Irvin J. Kahn, by grant deeds dated April 20, 1967, transferred the Sorrento Property to University City [Ex. K]. At the time of the filing of the Petition herein, University City held the Sorrento Property as an asset [R. 21]. By virtue of the automatic stay order, The Sixty

Trust was enjoined from foreclosing its deeds of trust encumbering the Sorrento Property [R. 27-28; Title 11 U.S.C. § 548].

Subsequent to the filing of the Petition, The Sixty Trust, pursuant to Section 137 of the Bankruptcy Act (Title 11 U.S.C. § 537), filed an Answer to the Petition seeking a dismissal of the action asserting, among other grounds, that the transfer of the Sorrento Property by Kahn and Tavares to University City on the eve of filing the Petition, for the admitted sole purpose of bringing said Sorrento Property within the injunctive power of the Court so as to restrain, hinder, delay and prevent The Sixty Trust from proceeding with a foreclosure sale under a certain deed of trust encumbering said Sorrento Property, demonstrated that the Petition had not been filed in good faith [A. 4-5; R. 40-41].

After a hearing before the Referee and Special Master on the issues raised by said Answer, the Referee issued a Report [R. 76-77], made Findings of Fact and Conclusions of Law [R. 78-81], which included holdings to the effect that the Petition had been filed in good faith [R. 80] and that the transfer of the Sorrento Property to the debtor did not result in a fraud upon any creditor [R. 77], and which were confirmed, approved and adopted by the District Court by its order entered October 3, 1967 [R. 102].

#### **Questions for Decision by This Court.**

The sole issues before this Court are whether two individuals may segregate a portion of their individually owned property, transfer that property to a controlled corporation, and then cause that corporation to file a Reorganization Petition so as to bring said prop-

erty within the automatic injunctive power of the District Court and thus protect their individual equity in said property from foreclosure by the holder of deeds of trust encumbering said property; whether such a transfer on the eve of filing of the Reorganization Petition shows such a total absence of good faith as to taint the entire proceeding requiring a dismissal of the Petition; and whether such a transfer shows a sufficient lack of good faith to require, at the very minimum, the exclusion of the transferred property from the reorganization proceeding and the vacating of the restraining order relative to said property.

#### Specification of Errors Relied Upon.

1. The District Court erred in confirming and approving the Referee and Special Master's Report.
2. The District Court erred in approving the Report of the Referee to the effect that the transfer by certain shareholders of University City of the 900 acres of Sorrento Property to the debtor on the eve of filing the Petition was not a fraud on any creditor.
3. The District Court erred in adopting the Findings of Fact and Conclusions of Law of the Referee and Special Master's Report.
4. The District Court erred in adopting the finding of the Referee to the effect that the debtor's Petition was filed in good faith as required by Section 144 of the Bankruptcy Act.
5. The District Court erred in adopting the conclusion of law of the Referee to the effect that the debtor's Petition satisfactorily complies with the requirements of Chapter X of the Bankruptcy Act.

6. The District Court erred in adopting the conclusion of law of the Referee to the effect that the Petition was filed in good faith and should be approved.

7. The District Court erred in adopting the conclusion of law of the Referee to the effect that the debtor is entitled to relief under Chapter X of the Bankruptcy Act.

8. The District Court erred in adopting the conclusion of law of the Referee to the effect that The Sixty Trust is not entitled to have the Petition dismissed and that their prayer for dismissal should be denied.

9. The District Court erred in adopting the conclusion of law of the Referee to the effect that the Petition in Chapter X of the debtor should be approved and that The Sixty Trust's prayer for dismissal of said Petition should be denied.

10. The District Court erred in approving the Petition of the debtor for relief under Chapter X of the Bankruptcy Act.

### **Summary of Argument.**

On the question of good faith, The Sixty Trust contends that the District Court erred in approving and adopting the Referee's Report to the effect that the transfer of the Sorrento Property to University City (on the eve of filing of the Petition herein) by two of its principal shareholders, officers and directors did not result in a fraud upon any creditor.

Carlos Tavares, the president of University City, and the sole witness called by the debtor at the hearing to sustain its burden of establishing good faith, admitted that the sole purpose of the transfer was to protect the

individual equity held by Tavares and Kahn in said Sorrento Property from foreclosure by The Sixty Trust.<sup>1</sup> The evidence presented at the hearing on this issue compelled but one conclusion—that said transfer was an attempt by Tavares and Kahn to segregate a *portion* of their total personal assets so as to bring them within the injunctive powers of the District Court—protection that would not otherwise be available. Had Kahn and Tavares filed individual bankruptcy proceedings, *all* of their assets would have been submitted to the jurisdiction of the court and would have been available to the creditors for satisfaction of claims. The transfer by Tavares and Kahn to University City of only the portion of their assets subject to deeds of trust held by The Sixty Trust, for the purpose of preventing foreclosure sales demonstrates a complete lack of good faith and constitutes a fraud upon The Sixty Trust. The District Court's sanction of this transfer is clearly erroneous.

**The District Court Erred in Approving, Adopting and Confirming the Report of the Referee to the Effect That the Transfer of the Sorrento Property on the Eve of Filing the Petition Did Not Result in a Fraud Upon Any Creditor.**

Carlos Tavares, the president of University City since its incorporation and a director and a principal shareholder [V. I; 19:9-20; V. I; 21:3-5; V. I; 43:25-44:18], testified that, although University City was a record owner of 2,400 acres of land on the date the

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<sup>1</sup>“Q. And why was it you deeded that particular property to University City?

“A. Well, we deeded it to University City because we wanted to protect our interest in the land that was being foreclosed by Sixty Trust.” [V. I, 31:20-24].

Petition was filed [V. I; 20:18-21], approximately 900 of those acres (the Sorrento Property) had been transferred to University City immediately prior to the filing of the Petition [V. I; 28:9-13; Ex. K]. The testimony established that until December 30, 1966, these 900 acres of property had been owned by Sorrento Properties, Inc., a California corporation, owned by Tavares and Irvin Kahn [V. I; 30:26-31:4]. Sorrento Properties, Inc. was dissolved in December, 1966 [V. I; 30:16-19; Exs. F, G, and I], and all of its assets, including the 900 acres referred to herein as the Sorrento Property, were transferred to Tavares and Kahn, individually [V. I; 31:5-15; Exs. I and J]. The Sorrento Property was held by Tavares and Kahn individually until they transferred it to University City a few days prior to the filing of the Petition by grant deeds dated April 20, 1967 [V. I; 31:16-19; Ex. K]. At the time of the transfer by Kahn and Tavares of the Sorrento Property to University City, ninety-nine percent of said property was subject to deeds of trust in favor of The Sixty Trust [V. I; 24:12-23 and 31:25-32:6] and a Notice of Default and Election to Sell under said deeds of trust had been published by The Sixty Trust [V. I; 32:7-9].

The timing of the transfer by Tavares and Kahn to University City and the filing of the Petition by University City leads inescapably to the conclusion that said transfer was accomplished solely for the purpose of bringing said property within the injunctive jurisdiction of the Court so as to protect the individual equity of Kahn and Tavares in said property.

It is not necessary to rely upon an inference in the instant case—however compelling that inference may be—

since one of the principals involved, namely Tavares, admitted under oath that he and Kahn "deeded [the Sorrento Property] to University City because [they] wanted to protect [their] interest in the land that was being foreclosed by Sixty Trust" [V. I; 31:22-24]. The Board of Directors of University City had full knowledge of the purpose of the transfer [Ex. D].

The foregoing evidence supports but one finding, namely that the transfer by Tavares and Kahn of the Sorrento Property to University City was accomplished for the sole purpose of bringing the Sorrento Property within the injunctive powers of the District Court and was intended to hinder, delay and prevent The Sixty Trust from proceeding with the noticed foreclosure sale and that such purpose was known to and acquiesced in by the Board of Directors of University City.

Bankruptcy Courts have consistently refused to sanction such transfers and have refused to maintain continuing jurisdiction of such schemes.

In *Milwaukee Postal Building Corp. v. McCann* (8th Cir. 1938), 95 F. 2d 948, a corporation issued bonds secured by a deed of trust upon certain property owned by said corporation. Subsequently, the real property encumbered by said deed of trust was transferred to an individual who held title subject to the deed of trust securing the bonded indebtedness. Defaults under the terms of the bonds occurred. After an unsuccessful attempt to resolve his difficulties with the bondholders, the individual owner of the real property formed a corporation, transferred all of his right, title and interest in said real property to the newly formed corporation, and caused said corporation to file a petition for re-

organization under the then applicable Section 77(b) of the Bankruptcy Act.

The Circuit Court of Appeals, in affirming the lower court's dismissal of the petition, held that Section 77(b):

“[I]s confined to instances where the debtor is a corporation. It has nothing to do with the situation where the debtor is an individual or a partnership—sections 74 and 75, as amended, U.S.C.A. Title 11, §§ 202 and 203, cover the field as to individuals in so far as Congress deemed it wise so to do. It deals solely with corporate reorganizations. This being true, *it is clear that it would be not only a legal fraud upon creditors, but without the intendment of this section to construe as within the section a corporation formed to and taking over the property of an individual debtor for the purpose of utilizing the section. \* \* \**” (Emphasis added).

*Milwaukee Postal Building Corp. v. McCann*, 95 F. 2d 948, 950.

The Court further emphasized that:

“There is a duty in the courts to see that provisions of the act are not abused and that its privileges are extended only to those who are within the contemplation of the act.”

*Milwaukee Postal Building Corp. v. McCann*, 95 F. 2d 948, 950.

The holding of the *Milwaukee* case is persuasive, if not compelling, authority for the proposition that the transfer of the Sorrento Property by Kahn and Tavares to University City a few days prior to the filing of the

Petition constituted grounds for dismissal of the Petition.

The fact that title to the Sorrento Property was held by a corporation prior to its transfer to Tavares and Kahn affords no distinguishing feature since the identical situation was likewise present in the *Milwaukee* case.

So too, in *In re North Kenmore Building Corp.* (7th Cir. 1936), 81 F. 2d 656, the Circuit Court reversed the District Court's denial of the motion to dismiss, concluding that the creation of a corporation by an individual in order to obtain greater protections for his individual assets constituted the type of scheme which could not be countenanced by a Court since the law was not intended to allow individuals to:

“[C]lothe themselves in corporate garments for the purpose of taking advantage of the statutes appertaining thereto if, in financial extremis, the law respecting corporations seemed to afford greater advantages. \* \* \*”

*In re North Kenmore Building Corp.*, 81 F. 2d 656, 657.

Nor is it necessary that the transfer be fraudulent as to the secured creditors; it is sufficient if its effect and purpose is to hinder and delay said creditors from enforcing their liens. Thus, in *Shapiro v. Wilgus* (1932), 287 U.S. 348, 77 L. Ed. 355, the United States Supreme Court, in an opinion by Justice Cardozo, held that a conveyance of all of an individual's property to a corporation could not be sustained even if the debtor's aim had been to prevent the disruption of his

business by creditors and to cause all of his assets to be protected for the benefit of all concerned.

The Court found that:

“[T]he sole purpose of the conveyance was to divest the debtor of his title and put it in such a form and place that levies would be averted. \* \* \*”

*Shapiro v. Wilgus*, 287 U.S. 348, 353-354, 77 L. Ed. 355, 358.

As such it could not be sanctioned because:

“A conveyance is illegal if made with an intent to defraud the creditors of the grantor, but equally it is illegal if made with an intent to hinder and delay them.”

*Shapiro v. Wilgus*, 287 U.S. 348, 354, 77 L. Ed. 355, 358.

*See also:*

*Mongiello Bros. Coal Corp. v. Houghtaling Properties, Inc.* (5th Cir. 1962), 309 F. 2d 925;

*Sherman v. Collins* (8th Cir. 1934), 75 F. 2d 62;

*In re Cosgrave* (S.D. Cal. 1935), 10 F. Supp. 672.

The intent and effect of the transfer by Kahn and Tavares to University City is factually indistinguishable from the intent and effect of similar schemes condemned in the foregoing cited authorities; the fact that Kahn and Tavares were not required to form a new corporation because of their control of an existing corporation is of no moment. The determining factor is that rather than each filing an individual bankruptcy proceeding and making all of their assets subject to creditor's claims, Kahn and Tavares segregated only a

portion of their holdings, namely the Sorrento Property, and transferred the same to University City, thereby shielding the Sorrento Property from foreclosure without subjecting their remaining assets to the jurisdiction of the Court. Moreover, they subjected the Sorrento Property, upon which The Sixty Trust held a secured lien, to the claims of the creditors of University City who would not otherwise have had the right to look to said property for satisfaction. Such manipulations of ownership for the purpose of hindering and delaying secured creditors from enforcing their liens have not and cannot be countenanced.

The District Court erred in refusing to follow these well-established precedents; it erred in approving, confirming and adopting the Referee's Report to the effect that the transfer of the Sorrento Property did not work a fraud on any creditor and it erred as a matter of law in approving the Petition as having been filed in good faith.

### Conclusion.

The Sixty Trust submits that the only finding consistent with the testimony in this case is a finding to the effect that transfer by Kahn and Tavares of the Sorrento Property to University City on the eve of the filing of the Petition solely to bring said property within the scope of the injunctive power of the District Court so as to enjoin The Sixty Trust from proceeding with foreclosure sales under its deeds of trust securing said property demonstrates such a lack of good faith as to compel, as a matter of law, a dismissal of the Petition of University City in its entirety. This is particularly true where, as here, the Board of Directors of University City knowingly participated in the scheme.

Accordingly, The Sixty Trust respectfully petitions the Court of Appeals for its judgment reversing the order of the District Court approving the Petition and directing the District Court to dismiss said Petition as not having been filed in good faith.

Alternatively, The Sixty Trust respectfully petitions the Court of Appeals for its judgment reversing the District Court's approval of the Petition insofar as it relates to the Sorrento Property and directing that the Sorrento Property be segregated from the remaining assets of this estate, that the Order restraining the stay be vacated insofar as it relates to such property, and that Appellants herein be given leave to enforce their liens against said property and to foreclose their deeds of trust thereon in accordance with the terms thereof as authorized by the laws of the State of California.

MARSHA K. McLEAN,  
GIBSON, DUNN & CRUTCHER,  
*Attorneys for Appellant*  
*The Sixty Trust.*